PART II.

"Sec. 2. *Rate.*—For the privilege of exercising its franchise in this state in a corporate or organized capacity, every domestic corporation, and for the privilege of doing business in this state every foreign corporation, liable to tax under this act shall annually pay to this state for the privilege of carrying on or doing business by it within this state, a franchise tax to be measured by its net income to be computed in the manner hereinafter provided at the rate of two per cent upon the basis of its net income as herein computed for the next preceding fiscal or calendar year.

"Sec. 3. *Basis on business within the state.*—If the entire business of the corporation be transacted within the state the tax imposed shall be based upon the entire net income of such corporation for such fiscal or calendar year. If the entire business of the corporation be not transacted within the state and its gross income derived from business done both within and without the state, the determination of its net income shall be based upon the business done within the state and for the purpose of computing such net income the commissioner of taxes shall adopt such recommendations and regulations for the allocation of net income as will fairly reflect the net income of that portion of the business done within the state." (p. 37.)

IV. Date of Judgment and Date of Application for Appeal.

The judgment sought to be reversed was entered on November 7, 1934. The application for appeal is presented on February 4, 1935.

V. Nature of the Case and of the Rulings of the Supreme Court of the State of Vermont.

The nature of the case is as follows:

James C. Colgate, the appellant, a resident and citizen of Bennington, Vermont, who was, throughout the year 1931,

a married individual living with his wife, and who derived income from the ownership of or interest in stocks, bonds, notes and other interest bearing securities and otherwise, seasonably filed an individual income tax return for the calendar year 1931 showing a tax of $7,176.13, accompanied by a payment of one-quarter of the tax indicated thereby, and a written protest against the requirement of such return and the collection of such tax. He subsequently paid the balance of said tax under like protest.

1. Included in said tax of $7,176.13 was a tax at the rate of four per cent on income amounting to $130,875.39 received by said James C. Colgate in the year 1931 as dividends or parts thereof on stocks of corporations, the income of which was in whole or in such parts not subject to taxation as against said corporations at the rate of two per cent under Part II of said Public Act No. 17 because earned *without* the State of Vermont, while no tax was imposed under said Public Act No. 17 upon the amounts received as dividends or parts thereof on stocks of corporations, the income of which was in whole or in such parts subject to taxation as against said corporations at the rate of two per cent under Part II of said Act because earned *within* the State of Vermont.

2. There was also included in said tax of $7,176.13 a tax at the rate of four per cent. on income amounting to $25,945, received by said James C. Colgate in the year 1931 as interest on account of money loaned without the State of Vermont at a rate of interest not exceeding five per cent. per annum upon obligations of the classes enumerated by said Public Act No. 17, in Part I, Sec. 3, Par. Second, Subd. (a) thereof, while no tax was imposed under said Public Act No. 17 upon the amounts received as interest on account of money so loaned within the State of Vermont, bearing such interest and evidenced by such obligations.

3. There was also included in said tax of $7,176.13, a tax at the rate of four per cent. per annum on income amounting to $21,927.77 received by said James C. Colgate in the year 1931 as interest on account of money loaned without the State of Vermont at a rate of interest exceeding five per cent. per annum upon obligations of the classes enumerated by said Public Act No. 17 in Part I, Sec. 3, Par. Second, Subd. (a) thereof, while no tax was imposed under said Public Act No. 17 upon the amounts received as interest on account of money so loaned within the State of Vermont, bearing interest at a rate not exceeding five per cent. per annum and evidenced by such obligations.

4. There was also included in said tax of $7,176.13 a tax at the rate of four per cent. per annum on $800 of income derived from his ownership of and interest in stocks, bonds, notes, and other interest bearing securities, which $800 of income would have been, as a personal exemption, eliminated from taxation by Section 3 of said Public Act No. 17 of the Public Acts of 1931 of the State of Vermont, if he had not received any income other than that derived from said sources.

On August 27, 1932, pursuant to Section 26, Part I, of said Public Act No. 17, he made application to the Commissioner of Taxes of the State of Vermont for a revision of such tax on the ground, among others, that his privileges and immunities as a citizen of the United States and a citizen of the State of Vermont had been abridged, and he was being deprived of his property without due process of law and he was being denied the equal protection of the laws and that interstate and foreign commerce was being interfered with in violation of the provisions of the Constitution of the United States by said Public Act No. 17, in that,

1. Said law classified and taxed at four per cent. per annum that part of his income for the year 1931 from stocks

of corporations so as to impose a greater burden upon his acquisition, possession and enjoyment of stocks of corporations which do all, or part, of their business outside the State of Vermont, amounting to $130,875.39, than is imposed upon the acquisition, possession and enjoyment of stocks of corporations which do all, or a corresponding part, of their business in the State of Vermont.

2. Said law classified and taxed at four per cent. per annum that part of his income for the year 1931 derived from interest on money loaned without the State of Vermont at not exceeding five per cent. per annum evidenced by obligations of the classes enumerated by said Public Act No. 17 in Part I, Sec. 3, Par. Second, Subd. (a) thereof, amounting to $25,945 and imposed no tax in case of such a loan of money at the same rate of interest within the State of Vermont.

3. Said law classified and taxed at four per cent. per annum that part of his income for the year 1931 derived from interest on money loaned either within or without the State of Vermont at a rate exceeding five per cent. per annum evidenced by obligations of the classes enumerated by said Public Act No. 17 in Part I, Sec. 3, Par. Second, Subd. (a) thereof, amounting to $21,927.77 and imposed no tax upon the amounts received as interest on account of money so loaned within the State of Vermont bearing interest at a rate not exceeding five per cent. per annum and evidenced by such obligations.

4. Said law taxes $800 of that part of his income derived from his ownership of and interest in, stocks, bonds, notes and other interest bearing securities, but would have eliminated the tax upon said $800 of income (as a personal exemption), if he had not received any income other than that derived from said sources.

Said application resulted in a decision of the said Tax Commissioner that the tax assessed, as shown by the return on file, was not excessive and was correct and resettling and computing such tax at the sum so shown.

On March 1, 1933, pursuant to Section 27, Part I, of said Public Act No. 17, said James C. Colgate filed his petition in the Washington County Court of the State of Vermont, asking, among other things, that the taxes, interest or penalties illegally assessed as aforesaid, be ordered refunded to him with interest, and that judgment be entered accordingly, upon the constitutional grounds hereinbefore set forth and upon other grounds. Said petition was heard on an agreed statement of facts, which comprehended all matters of fact alleged in the petition and application and the full payment of said tax under protest, and also on the argument of plaintiff's counsel, and resulted in a judgment for the defendant.

On February 15, 1934, said James C. Colgate brought his petition before the Supreme Court of the State of Vermont for a review and final decision of the said questions of constitutional law and other questions of law by said Supreme Court on his bill of exceptions, each and every of which exceptions was overruled by said County Court. Said bill of exceptions contained exceptions to said judgment of the County Court upon the constitutional objections hereinbefore specified as well as other exceptions.

At a General Term of the said Supreme Court begun and held at Montpelier, Vermont, on the first Tuesday of November, A. D. 1934, said Supreme Court made and entered a final judgment affirming the said judgment of the County Court.

The final judgment of said Supreme Court of the State of Vermont affirming said judgment of said County Court against said James C. Colgate was a ruling by the highest court of said State of Vermont in which a decision in said

suit then could, or now can be had, in favor of the validity of said Public Act No. 17 of the Public Acts of 1931 of the State of Vermont, the validity of which, on the ground of its being repugnant to the Constitution of the United States, had been drawn in question by said exceptions to the judgment of said County Court upon the constitutional grounds hereinbefore set forth.

In its opinion (*Colgate* v. *Harvey*, 175 Atlantic Reporter 352, not yet officially reported), the Vermont Supreme Court stated the grounds upon which the constitutionality of said Public Act No. 17 was challenged as follows:

> "(1) That it contravenes section 2 of article 4 of the Federal Constitution, which provides that the citizens of each state shall be entitled to all the privileges and immunities of the citizens in the several states.
>
> "(2) That it infringes the Fourteenth Amendment to that Constitution, which provides that no state shall deprive any person of life, liberty, or property without due process of law or deny to any person within its jurisdiction the equal protection of the laws.
>
> "(3) That it violates articles 1 and 7 of our Bill of Rights, which, speaking broadly, provide for the equality of individuals before the law.
>
> "(4) That it results in an unwarranted interference with interstate commerce.
>
> "(5) That it attempts to tax the income from dividends on stock in foreign corporations which is tantamount to a tax on the stock itself which has a taxable situs beyond the jurisdiction of this state."

The opinion then states that the court found nothing in the statute that conflicts with the state or federal constitutions.

VI. Cases Believed to Sustain the Jurisdiction of the Supreme Court of the United States.

Cases Condemning State Taxation Discriminating Against Investment in Sister States.

The appellant here is a citizen of the United States and of Vermont. By the Act called into question, Vermont levies an income tax which, in effect, taxes dividends earned outside of Vermont and exempts dividends earned within Vermont,[1] and which also, in effect, taxes income from loans made outside of Vermont at not exceeding five per cent interest and exempts income from loans within Vermont at not exceeding five per cent interest.[2]

The appellant's position is that these provisions of the Act deprive citizens of the United States and of Vermont of the right to which they are entitled under Article IV, Section 2, of the Constitution and the Fourteenth Amendment and the Commerce Clause, to invest in non-Vermont stocks and bonds on at least as favorable terms as in Vermont stocks and bonds.

What Vermont has done in substance is to announce that income over which Vermont has territorial jurisdiction shall be tax free and income over which Vermont has no territorial jurisdiction, but only a jurisdiction through the residence of the owner, shall be taxed. Of all the classifications that might have been chosen for the purposes of taxation, the most clearly unconstitutional is that which exempts intra-state income and taxes extra-state income.

In *Chalker* v. *Birmingham & N. W. Ry. Co.*, 249 U. S. 522, 527, there was involved the constitutionality of a stat-

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[1] Pt. I, § 3, Par. Second and Subd. (d) thereof and Pt. II, § 3.

[2] Pt. I, § 3, Par. Second and Subd. (a) thereof.

ute of the State of Tennessee, which imposed an annual tax for the privilege of doing work within the state, amounting to $25 if the chief office of the person or corporation doing the work was in the State of Tennessee, and to $100 if it were not. The United States Supreme Court held that the statute was unconstitutional on the ground that it violated Section 2 of Article IV of the Constitution. In other words, the case held that under Section 2 of Article IV of the Constitution, a state cannot discriminate against citizens of other states by making the location of the principal place of business within or without the state the deciding factor in determining whether the tax for exercising privileges within the state shall be the minimum or the maximum. In that case, the statute made the residence of the taxpayer the determining factor as between the imposition of the tax of $25 or the tax of $100 each of which it had jurisdiction to levy.

It is submitted that the Fourteenth Amendment contains an equally effective prohibition against making the extra-state source of income the basis of discrimination against it in income taxation.

An application of the Fourteenth Amendment somewhat similar to that here suggested was made in *F. S. Royster Co.* v. *Virginia,* 253 U. S. 412, 416. In that case, the United States Supreme Court held that a state law, which taxed all income of local corporations doing business both outside and inside the state but exempted all income of local corporations doing business outside the state only, was arbitrary and violated the equal protection clause of the Fourteenth Amendment.

The discrimination in that case favored extra-state business and involved only a domestic corporation, the creature of the taxing state. Yet it was condemned as unconstitutional. In the case at bar, the discrimination favors business within the state and discriminates against a natural

person. It is submitted that the discrimination in the case at bar is *a fortiori* unconstitutional.

In *Klein* v. *Board of Supervisors,* 282 U. S. 19, 23, where the claim was made that the statute discriminated against extra-state business, the United States Supreme Court answered that what at first appeared to be discrimination was substantially justified. However, the Court in so holding laid down a rule for determining whether such apparent discrimination is justified.

In that case, the United States Supreme Court sustained a Kentucky statute which taxed shares of corporations in the hands of the shareholder. The statute exempted the shares of those corporations which paid taxes to Kentucky on at least 75% of their total property. In sustaining the tax, Mr. Justice Holmes said at pages 23-24:

> "If the corporation having all its property in the state has paid taxes upon the whole, usually it would be just not to tax the stockholders in respect of values derived from what already has borne its share. And what would be true in the case supposed would be true when the corporation was paying for the great body of its property although some small fraction happened to be outside of the state. Thus we come to the usual question of degree and of drawing a line where no important distinction can be seen between the nearest points on the two sides, but where the distinction between the extremes is plain. • • •
>
> "We agree with the Court of Appeals that there could have been no question if the statute had said ninety per cent and that fixing seventy-five was equally plainly 'a reasonable effort to do justice to all in view of the way all our other assessments are made'."

In the case at bar, the so-called income tax upon dividends is a flat tax of four per cent.[3] There is a franchise

[3] Pt. I, § 3, Par. Second.

tax on corporations (under Part II of the Act) amounting to two per cent of the net income of the corporation from business done within the State of Vermont.[4]

The Kentucky tax was sustained in the above quoted *Klein* case on the theory that exemption of stockholders from taxation on their stock may be justified by showing that "all but a small fraction of" the property represented by the stock "already has borne its share" of the support due the state by being taxed in the hands of the corporation. In that case, it might be said in substance that 75% of the property represented by the stock had already borne its share of Kentucky taxation so that it was substantially fair to exempt the whole in the hands of the stockholder. The property had borne 75% of its burden and the Legislature in deciding the question of degree was held to be within constitutional limitations in treating it as though it had borne its entire burden.

In the case at bar, however, even if we should regard the tax on the net income of the corporation and the tax on the dividends paid the stockholders as taxing the same property, that property has borne but 50% of its burden in the hands of the corporation for the income tax is four per cent. and the corporation tax is but two per cent. The justification for the territorial discrimination in the *Klein* case—the fact that the property had already borne 75%, or "all but a small fraction" of its burden—is not available here. The property here has, at most, borne 50% of its burden.

If the *Klein* case should be deemed to sustain territorial discrimination where the property had, as here, borne but 50% or its burden, the case at bar would then raise the question whether the rule of the *Klein* case still has validity in view of the subsequent decision of the United States Su-

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[4] Pt. II, §§ 2 & 3.

preme Court in *First National Bank* v. *Maine,* 284 U. S. 312, 328. That case applied the rule of single situs for intangible property to shares of stock. The United States Supreme Court has not yet decided whether that principle brings cases such as the case at bar within the rule of *Frick* v. *Pennsylvania,* 268 U. S. 473, 494-495, that the State cannot measure taxes by matters beyond its jurisdiction.

The Commerce Clause furnishes another basis for invalidity of the statute here involved, particularly with respect to the tax upon interest from loans made outside of Vermont where there is no corresponding tax upon interest from loans made within Vermont. Looking at the question realistically, this tax situation discourages Vermont residents from making loans outside of Vermont and thus aproximates an embargo upon the exportation of capital from Vermont into other States. The decisions of the United States Supreme Court condemn any "burden upon the occupation or the privilege of carrying on (interstate) commerce, whatever may be the instrumentalities or means employed to that end." (*New Jersey Telephone Co.* v. *Tax Board,* 280 U. S. 338, 346.)

Case Condemning the Rate of Interest as a Basis for Discriminating Between Taxable and Tax Exempt Property.

The statute in the case at bar, beside taxing all interest earned outside of Vermont, taxes all interest earned within Vermont at a rate in excess of five per cent.[5]

The use of a variation in the interest rate as a basis for tax classification has been condemned. (*Louisville Gas & Electric Co.* v. *Coleman,* 277 U. S. 32.)

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[5] Pt. I, § 3, Par. Second and Subd. (a) thereof.

Case Condemning the Arbitrary Refusal of the $800 *Exemption.*

The statute under consideration deals with two classes of income which it defines: First, what may be referred to as earned income[6] and, second, income from investment.[7] An exemption of $800, is applicable against the investment income *but only if there is no earned income.*[8] No justification for this extraordinary provision has been found. As a basis for classification for tax purposes, it is as arbitrary as the difference in rates of interest which in *Louisville Gas & Electric Co.* v. *Coleman*, 277 U. S. 32 (*supra*) was held to be an unconstitutional basis.

Cases Holding That Appeal Is the Proper Remedy.

Safe Deposit and Trust Company of Baltimore v. *Virginia*, 280 U. S. 83.

Baldwin et al. v. *Missouri*, 281 U. S. 586.

Dated: January 31, 1935.

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[6] Pt. I, § 3, Par. First.
[7] Pt. I, § 3, Par. Second.
[8] Pt. I, § 3, Par. Second, Subd. (a) and Subs. Second thereof.